A guide to FARM ESTATE PLANNING IN MANITOBA

Canada

Growing Forward 2
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Manitoba

A Legal Guide to Farm Estate Planning in Manitoba

The surest way to reach a business goal is to plan on it. Successful Manitoba farmers are focused business people. They have clear, flexible, short and long term business plans – and they monitor their plans regularly.

Whether you're starting, growing or passing along your business, you need a solid business plan. Manitoba Agriculture can help you build a plan for success.

When selling or transferring your business (inside or outside the family), you need a solid business or estate plan that provides the most benefits. A successful estate plan includes more than a will and power of attorney. It also prepares for such things as:

- **transferring property within your lifetime**
- **transferring property at your death**
- **trusts, insurance, family law**

Use this as a tool to help get you there.

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Version one of this publication was completed with the valuable contribution of Mona G. Brown and Laura Martens.

This publication is available in alternate formats upon request.

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Definitions

Who is a farmer?

In tax and estate planning, the definition of farmer is important. The Canada Revenue Agency includes the following as farming activities:

- soil tilling
- livestock raising or exhibiting
- racehorse maintenance
- poultry raising
- fur farming
- dairy farming
- fruit growing
- beekeeping

Specifically excluded from farming is an office or employment under a person engaged in the business of farming, for instance, a hired man of a farmer.

Generally, a farmer is someone engaged in a farming activity, who takes on the element of risk in the overall business operation.

Common examples of activities not considered farming are:

- renting land on a cash basis
- share crop rental

Capital Gains

When property is sold, there may be a great difference between the fair market value and the original purchase price (cost base). A capital gain is the difference between the cost base of property (or V-Day value if owned prior to December 31, 1971, please see page 20 for more information) and its fair market value. When property is sold or a property owner dies, the *Income Tax Act* generally deems the vendor or deceased has sold at fair market value, and assesses capital gains or losses. There are some exceptions for farm property.

Capital Gain = Fair Market Value – Cost Base

Currently in Canada, a capital gain is included as income at 50 per cent of the total gain. The federal and Manitoba tax systems for individuals are graduated income tax systems. Income levels are broken into various brackets with tax rates applicable to each bracket. As income level increases, the tax rate applicable typically also increases. Assuming the farmer is an individual, the taxable portion of the gain is added to all other sources of income and applicable federal and provincial tax brackets determine tax payable.

Capital Gains Exemption

Each individual has a $1,000,000 lifetime capital gains exemption to use to offset capital gains that will occur when qualified farming or fishing property is sold or deemed sold. The $1,000,000 exemption is applicable to dispositions on or after April 21, 2015 of qualified farm or fishing property. For dispositions from January 1, 2015 to April 20, 2015, the lifetime exemption limit was $813,600.

Because 50 per cent of capital gains are taxable, each farmer has an exemption of $500,000 of taxable capital gain for dispositions after April 21, 2015.

Note that farming corporations do not have a capital gains exemption, only individuals do. A shareholder can use the capital gains exemption on shares of a family farm or fishing corporation. A partner can use the capital gains exemption in the sale of a partnership interest in a qualified family farm or fishing partnership.

Recapture

For depreciable assets such as buildings and equipment, recapture is the difference between the original cost base and the undepreciated capital cost. Recapture is taxable in full.

Spouse or Common-law Partner

Spouses and common-law partners of three years or more have equal rights under Manitoba family property legislation. Any time a spouse is referred to in these materials, the provisions apply equally to common-law **partners of three** years or more, or those who registered their common-law relationship with Vital Statistics of Manitoba.

What is estate planning?

Farmers have many estate planning options.

Estate planning is more than a will, a power of attorney or a health care directive. Estate planning can help you transfer property during your lifetime or at death, to maximize the benefits of government programs and minimize tax, while transferring your assets according to your wishes.

With smart planning, you can accommodate family legal situations, creditor proof your assets and minimize your farm's and your family's total tax payable during your lifetime and at death.

Estate planning requires an investment of your time and some money, but the return on your investment may be huge.

Benefits of an estate plan:

- tailor-made for your particular situation

- complies with applicable laws
- saves taxes
- allows you to preserve the farm for the next generation and provide for other family members
- ensures that your estate is settled cost effectively and without delay

Key point to remember: Estate planning is planning **now** to minimize tax during your life and later at the time of your death.

Estate Planning for Farmers during Lifetime

How to own property and hold your business

1) In your personal name:

Many people own property and farming assets in their personal names. There are several other ways to hold personal and business property. It's a good idea to learn about them and choose a way that fits your needs best.

2) Jointly with others:

Owning assets jointly with others is one way to estate plan.

General rule to remember: Joint-owned assets automatically go to the survivor or joint owner upon your death and will not be included in your estate for probate fees or to leave to others.

Generally, a way to access multiple capital gains exemptions is to purchase assets such as real property in joint tenancy with a spouse or common-law partner. Ownership can also be structured with children to access additional capital gains exemptions. You should speak with your professional tax and legal advisors about whether there are other concerns in doing so within your overall estate plan.

If your land or equipment is in your name alone, you will need to work with your professional tax advisor to find out whether you can access additional capital gains exemptions.

> **EXAMPLE 1:** Sam transfers his farmland into joint names with son, Harry. Some of Sam's bank accounts are held jointly with his daughter, Jane who assists him with banking. There are also two other children in the family.

The Supreme Court of Canada has held that, in such situations, property held jointly may be found to be held in trust by Harry and Jane for Sam. After Sam's death, Sam's other children may have a potential claim that the land and bank accounts were transferred into joint names to be held in trust for Sam, and not to benefit Harry and Jane.

Advantages: There are some advantages of joint ownership:

- It may minimize or avoid probate tax. Only a death certificate is required to a transfer a joint asset to the survivor. Probate fees in Manitoba are currently $70 on the first $10,000 of estate value and then $7 per $1,000 of assets. A million dollar estate would pay $7,000 in probate fees. Transferring property to joint names solely to avoid probate fees is probably not a good idea.

Unintended Consequences of joint ownership with someone other than a spouse or common-law partner:

- A transfer to someone other than a spouse or common-law partner (ex: a child) may trigger an immediate capital gain to the transferor.
- A child holding a bank account or real property jointly with a parent may be taxed on future income or capital gains generated by the bank account or real property, plus more tax (on capital gains) upon death and disposition of the account.
- A principal residence exemption may be lost.
- There is a risk of losing asset to creditors, whether intentional or not.
- The ability to make decisions and control the property might be lost.

The problem of having a joint asset found as held in trust could be solved by:

- drafting a trust document to preserve the parent's interest
- indicating that there is no intent to transfer beneficial ownership
- indicating there is to be no use by the child during the parent's life
- indicating that the asset must be shared with the other children upon death

3) Life interest or remainder interest

Life interest or remainder interest is a way to transfer and hold real property or other assets so that you have control of the asset and receive all income from the asset during your lifetime. On your death, the remainder (capital interest) automatically goes to the surviving remainder interest holder without being part of your estate.

EXAMPLE 2: John and Mary Smith want their farmland to go to their only child, Sara. They transfer the land as follows:

> To John Smith and Mary Smith, a life interest in possession for the term of their natural life, and to Sara Smith, a remainder interest expectant upon the death of the survivor of John Smith and Mary Smith.

John and Mary are entitled to all the income from the farmland for their lives. The farmland goes to Sara automatically, without probate fees, upon the death of the last of John and Mary. Capital gain on any increase in the value of the farmland after the transfer goes to Sara. Generally speaking, splitting a property into a life and remainder interest will involve dispositions for tax purposes. You should speak with your professional advisors to determine the consequences of moving forward with a life and remainder interest.

4) Tenancy in common with others

Holding property as tenants in common with others means parties hold property together, but there are no rights of survivorship. When a party dies, their portion goes into their estate and not to surviving parties.

Note that parties may each hold a different ownership interest.

EXAMPLES:

- farmland held 1/3 by John and 2/3 by Mary
- partnership assets held in common

5) In a spousal partnership or a family farm partnership

A partnership is a type of relationship that exists between people carrying on a business together or in common, with an intention to profit. Unlike a corporation, a partnership is not a legal entity separate from its partners, although partners may choose and register a partnership name. Accounting and legal professionals should be consulted in setting up a partnership. For tax purposes, the income of the partnership typically flows to the partners based on the income allocation specified in the partnership agreement and partners are taxed as individuals.

An individual's share in the partnership is called a partnership interest. If an individual wishes to sell or transfer a partnership interest, he or she may do so and use the capital gains exemption if it is an interest in a qualified farm or fishing partnership.

EXAMPLE 3: How to use a farm partnership and take advantage of the capital gains exemption:

- John and Mary set up a spousal partnership or partnership with children.
- They sell their partnership interests to the farm corporation instead of selling partnership assets after a time when the conditions necessary are satisfied.
- They may use their capital gains exemption on the sale of the partnership interest, which includes the value of inventory and equipment that do not otherwise qualify for the capital gains exemption.

- No capital gains are payable (though other taxes such as alternative minimum tax may be payable), assuming the partnership qualifies for the capital gains exemption.
- If John and Mary's partnership sold the equipment and inventory to an outsider, they could pay up to 46.4 per cent tax (for 2015) on the value of the inventory, recapture of capital cost allowance and capital gains on the equipment.

You should speak with your professional advisors to determine whether structuring as a partnership makes sense for you and whether the general strategy noted above is applicable to your situation.

6) In a joint venture

Generally, a joint venture refers to the joint relationship of parties to conduct a specific or limited commercial venture without becoming partners. Generally, the business enterprise is a single project or a specific type of project or for a certain length of time.

As with any commercial enterprise, it is important to have a written agreement governing the conduct and management of the joint venturers and describing specific services and assets each is contributing.

> **EXAMPLE 4:** John and his sons, Sam and Bob, each have their own farming corporations. They form a joint venture to share farming equipment, labour, expenses and grain storage. The agreement specifies who gets what percentage of the joint venture's profits. This can be worded very flexibly. Each of John, Sam and Bob's corporations keep its own small business base rate of tax (currently 11 per cent on the first $425,000 of income) within their own corporation because the ownership structure is such that the association provisions of the *Income Tax Act* are not met.

7) In a corporation

A corporation is a legal entity separate from its owners or shareholders. It can own assets and can carry on business in its own name and it must file a separate corporate tax return.

Corporations have shareholders (those who hold shares in the corporation). The directors and officers run the affairs and manage the corporation. Shareholders, directors and officers have limited liability and are generally not personally liable for the contracts or obligations of the corporation. There are however, some exceptions and directors have been held liable for some matters. Because farming is a dangerous occupation with risks, this limited liability may be important to shelter farmers' personal assets (house, farmland, bank accounts and investments).

Shareholders and directors should hold meetings as required by law and should keep up-to-date minutes of the meetings. You should take care in the handling of corporate funds and transactions to keep them separate from your personal affairs. In dealing with the public, you should always ensure that the full corporate name of the corporation is used on contracts, agreements, invoices, letters, cheques, signs, advertisements and other matters. Corporate documents should be signed properly by the appropriate officers, and they should make clear that they are signing on behalf of the corporation. Otherwise, courts may impose personal obligation on directors or shareholders.

Benefits of incorporation:

- limited legal liability (A corporation is a separate person under the law.)
- more favourable tax rates (Active business corporations are taxed at 11 per cent instead of 46.4 per cent tax on income up to $425,000 provincially and $500,000 federally as of 2015.)

Following examples answer a few of your questions and illustrate how incorporation can work for you:

- Example 5 – Should farmland be bought inside the corporation or personally by the farmer?
- Example 6 – Using two corporations to protect assets and manage taxes – Landco and Farmco.
- Example 7 – What if I want to continue farming and I am over the small business limit?
- Example 8 – What if I already have equity in my corporation that is equal to or exceeds the capital gains exemption?
- Example 9 – John and Mary want to create an estate plan for their farm and transfer the farm shares to their son Bob, but also provide for their other children, Sam and Alice.

EXAMPLE 5: You have incorporated your family farm and are now going to be buying a quarter-section of farmland. Should the farmland be bought inside the corporation or personally by the farmer?

ANSWER: There are advantages and disadvantages to both. It will generally be easier to repay debt if the corporation buys the farmland because lower corporate taxes allow more money for paying off debt. This is because a dollar earned by the corporation is taxed at 11 to 27 per cent while personal taxes can be 46 per cent or more. But once land is inside a corporation, it will not qualify for the capital gains exemption if the corporation later resells it (only individuals qualify for the capital gains exemption). If the shareholders sell the shares in the farm corporation, the sale of shares may still qualify for the capital gains exemption (see specific requirements below).

General Rule: If you have cash to buy land, keep land outside the corporation. However, if you have to borrow the funds to buy the land, have the corporation buy and repay the principal with the lower 11 per cent active business tax or 27 per cent general rate corporate tax.

EXAMPLE 6: The use of two corporations – one recommended way to incorporate:

- Set up two corporations – Farmco is the corporation that operates the farm. Landco holds the farmland.
- Farmco pays rent to Landco to make the mortgage payments.
- Landco and Farmco can have different shareholders.
- The two corporations may share one small business limit for the tax rate, depending upon the ownership structure.

Small business tax rates: The corporation will have a $425,000 small business limit for provincial tax and $500,000 for federal tax. For business income up to $425,000, the tax rate is 11 per cent. For business income between $425,000 and $500,000 the tax rate is 23 per cent, and thereafter, 27 per cent.

Investment tax rates: The corporation will be subject to a 46.67 per cent tax rate if the income earned is considered to be passive investment income. When sufficient dividends are paid from Landco to shareholders, Landco will receive a dividend refund of 26.67 per cent resulting in a net 20 per cent tax on investment income.

The land in Landco is not at risk to creditors. Later, if they want to sell the shares of Landco to an outside party, the shareholders can, in all likelihood, use their available capital gains exemption because Landco will be considered as a family farm or fishing corporation for purposes of the capital gains exemption, if structured properly. The purchaser buys the shares with another corporation and, on the amalgamation or wind-up of the two corporations, the purchaser may also get to bump the cost base of the land to its fair market value by filing a special election. Landco is essentially a holding corporation, not an operating corporation, and has very little risk of any outstanding liabilities, so there is no reason not to purchase shares.

Note - If structured so that Landco is associated to Farmco, the rent Landco earns will also be treated as active business income and will avoid the investment rate tax noted above.

EXAMPLE 7: What if I want to continue farming and I am over the small business limit?

- Incorporate a separate corporation for your spouse or common-law partner or children (provided they are not shareholders in your existing corporation, which would not pass the association test).
- Each corporation will have a $425,000 small business limit for provincial tax and $500,000 for federal tax.
- Farm in a joint venture.
- Do nothing and pay the general tax rate of 27 per cent on income over the small business limit. By paying general rate corporate tax, the corporation will have the ability to pay shareholders eligible dividends, which are tax preferential dividends at the personal level.

EXAMPLE 8: What if I already have equity in my corporation that is equal or exceeds the capital gains exemption?

- Do an estate freeze. This generally involves placing a fair-market value on your corporation and exchanging your common shares for preferred shares of equal value and electing to use your capital gains exemption on the exchange of shares. New shareholders (ex: your children who want to farm in the future, or perhaps a family trust) then purchase common shares for nominal consideration with the future growth of the corporation attributing to them.
- Full freeze – you give up all future growth.
- Part freeze – you give up part of the future growth.
- Life interest or remainder interest is a freeze on property value.

Note – you should speak with your professional advisors about accessing corporate equity through the use of the capital gains exemption. There are various provisions within the *Income Tax Act* that work to prohibit these types of transactions and therefore proper care and attention should be taken to avoid unnecessary consequences.

Shareholder agreements

It is wise for shareholders to enter into an agreement to govern matters between the shareholders. For instance, such an agreement may set out the procedure for an orderly withdrawal from the corporation upon death, retirement, divorce, disability or if one shareholder wants a voluntary sale. Entering into an agreement in advance can save a farmer a lot of trouble later on and could also serve to provide an estate plan that would save the deceased farmer's family a lot of tax after death.

EXAMPLE 9: John and Mary want to create an estate plan for their farm and transfer the farm shares to their son Bob, but also provide for their other children, Sam and Alice.

- The farming corporation, Farmco, obtains life insurance on John and Mary's lives, which is payable to Farmco, and based on the aggregate to the value of Farmco.
- John and Mary hire an independent valuator who values Farmco at fair market value of $1,500,000.
- John and Mary undertake an estate freeze and each take $750,000 of preference shares in Farmco in exchange for their common shares.
- Bob subscribes for new common shares for $100.
- In their wills, John and Mary leave their preference shares to Sam and Alice, provided they give Bob the right to buy the shares.
- On the deaths of John and Mary, the insurance proceeds are paid to Farmco. The death benefit received in excess of the adjusted cost base of the insurance policies will flow tax-free to Farmco's capital dividend account. Assuming the full $1,500,000 of death benefit will be considered an addition to the Farmco capital dividend account, these proceeds can be removed as a tax-free capital dividend to Bob as shareholder of Farmco.
- Bob uses the $1,500,000 to buy the preference shares from Sam and Alice, who can use their $1,000,000 capital gains exemption to avoid capital gains tax. Bob's cost base of the shares is now $1,500,000, however a portion of his cost is considered soft.
- Note: this can only be done if the shares qualify for the capital gains exemption and the parents or Sam and Alice have available capital gains exemption left.

- OR, if John dies, his shares can also roll (transfer tax free) to his spouse or common-law partner or children, preventing his estate from paying capital gains tax. The shares can then be redeemed by Farmco by paying a capital dividend to the spouse or common-law partner or children for their shares, tax-free.
- Remember: The shareholders agreement must be carefully worded by a lawyer to allow such a plan to proceed.

8) In a discretionary family trust

What is a trust? A trust is a legal entity by which a person, called the settlor, gives property to a person(s) called the trustee(s), to hold and use the property for the benefit of others, the beneficiaries.

In a discretionary trust, the beneficiaries are not entitled to any payments of income or capital unless the trustees, at their discretion, allocate a payment to them.

Following are several examples to answer a few of your questions and illustrate how trusts can work for you:

- Example 10 – Use your capital gains exemption now by transferring property to a trust.
- Example 11 – Use multiple capital gains exemptions and income splitting with a family trust.

EXAMPLE 10: John and Sara are nervous about transferring property to their children and losing control of the property, because the children are still young. They have used all of their capital gains exemption and want to avoid future capital gains. They do not know which of their children may want to farm.

SOLUTION: set up a family trust. A family trust gives you the ability to transfer future income and capital gains or growth to the next generation without losing control.

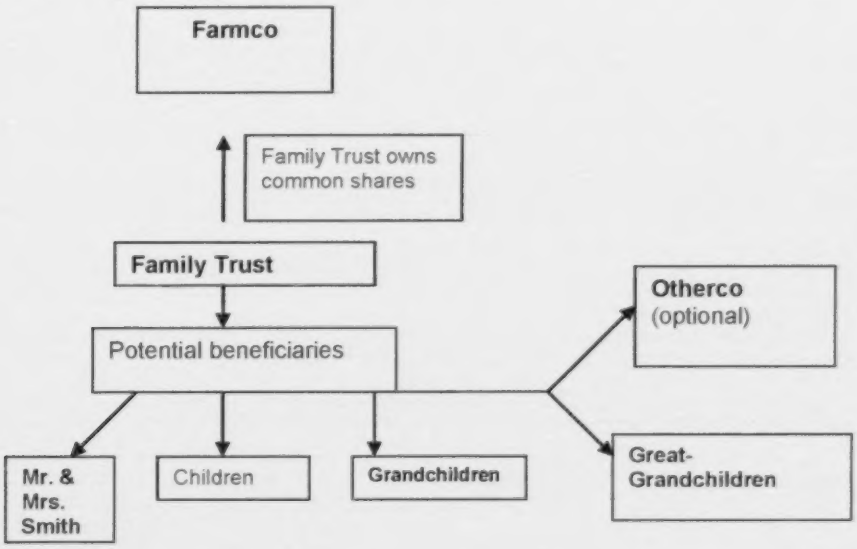
A trust can be used to:

- Crystallize your capital gain, giving future gain to the next generation, but giving you 21 years to decide who gets allocated the gain, because who gets what is totally up to the trustees. No beneficiary has any interest until allocated.
- Let you continue to have control.
- Allow the use of multiple capital gains exemptions by transferring capital gain to children or grandchildren, including infants.
- Income split with adult children and your spouse or common-law partner.
- Provide support to a beneficiary with special needs, while preserving the government assistance they receive.
- Protect against creditors.
- Provide for someone too young to manage an inheritance.
- Provide income to a loved one without the burden of managing.
- Protect your child from a spendthrift or controlling spouse or common-law partner.
- Protect assets for your child on dissolution of his or her marriage or common-law relationship.
- Continue your business achievements.
- Assist in family law proofing.

Use a discretionary family trust as the shareholder in the family farm corporation so that no beneficiary is entitled to any asset until the trustees (John and Sara and one outside trustee, a trusted family friend, professional advisor) decide to allocate to them. Entitlement only occurs when the trustees exercise their discretion and allocate income or capital.

Note – while family trust planning can in many times be advantageous, it is very important that the trust be properly documented and created. It is therefore strongly recommended, should a family trust be considered as part of the overall estate plan, that you obtain the proper professional advice. Failure to do so may result in significant unintended consequences.

Figure 1: Sample Family Trust Structure:



Set up of family trust to use multiple capital gains exemptions and income splitting.

EXAMPLE 11: Mr. and Mrs. Smith farm through a corporation. They have already used their capital gains exemption on the sale of farmland to their corporation. Mr. and Mrs. Smith have five children: three minors, two university students. Their professional advisors discuss the establishment of a family trust:

- To establish a family trust, someone other than Mr. and Mrs. Smith, their children or grandchildren (called the settlor), must direct the lawyer to establish the family trust.
- Mr. Smith's mother directs the family's lawyer to establish a family trust.

- For the trust to be properly created, the settlor must give something of value (often a gold coin or $100 bill), to the trustees to hold for the benefit of the beneficiaries. The settled property should never be used or negotiated. The trust will typically borrow money from a financial institution or arm's length party to source the necessary cash to buy the shares of Farmco or other property.
- In this case, to establish the family trust, Mr. Smith's mother (the settlor) transfers a gold coin to the trustees to create the trust.
- The settlor and the trustees agree that the trustees must hold the trust property (the gold coin) for the beneficiaries of the trust. The settlor cannot have any further ownership in the trust property or any further right to make decisions for the trust. The settler must never be in a situation to have the gold coin back.
- The trustees are Mr. Smith, Mrs. Smith and an outside trustee, Ms. Jones, who is neither a close relative nor someone with whom Mr. Smith and Mrs. Smith are shareholders with.
- The beneficiaries of the trust are Mr. Smith, Mrs. Smith, their children, their future grandchildren and great-grandchildren, (and optional: another newly incorporated corporation called Otherco, owned by Mr. Smith and Mrs. Smith).
- The family engages an independent business valuator to value Farmco.
- Mr. Smith and Mrs. Smith's common shares are exchanged for preferred shares equal in value.
- The trust obtains an overdraft from a bank and borrows $100 to subscribe for common shares in Farmco.
- All further growth of the corporation goes to the trust.
- Dividends are paid by Farmco to the trust and trustees will decide annually if any of these dividends are designated to beneficiaries of the trust, otherwise the trust will be taxed on the dividends as an individual.
- Dividends should generally not be allocated to minor children due to the kiddie tax rules.
- As a general example, the trust could allocate approximately $40,000 in dividends to each of the two children in university (whom are both over the age of 18) and if they have no other income sources, the $40,000 in Farmco dividends allocated through the trust would essentially be tax free, providing funds for tuition and living costs.

- Kiddie tax generally does not apply to capital gains. If none of the family wants to farm and the shares of the corporation are sold by the trust, any capital gain can be allocated to any or all of the beneficiaries including children or grandchildren. Regardless of their age, they can use their capital gains exemption. It should be noted that if the trust sells shares to a minor who is considered to be non-arm's length, the kiddie tax provisions will apply to the minor's capital gains.
- As an illustration, the family (Mr. and Mrs. Smith and their five children), by using a family trust, can access $7 million ($1 million x 7) of aggregate capital gains exemption on the trust's disposition of the Farmco common shares after April 21, 2015, to an arm's length party. Without trust planning, only Mr. and Mrs. Smith's exemptions would be used. Including grandchildren might make even more capital gains exemptions available.

Points to Remember:

- A trust is deemed to sell all of its assets at fair market value every 21 years and immediately reacquire the assets at a cost base equal to fair market value. Without proper planning, this 21 year rule could trigger unwanted tax consequences.
- A trust requires extra paperwork, additional bank accounts and extra tax returns.
- A trust must be carefully planned and documented; this point cannot be stressed enough.

Discretionary family trusts and the family farm corporation: Important rules to remember:

- The family farm corporation must have 90 per cent of its assets used primarily in the business of farming at the time of determination to meet the criteria necessary to be considered a family farm corporation. Additional criteria also apply.
- If you have excess cash in your Farmco, a family trust with another corporation as a beneficiary can be used to remove the cash in the corporation, purifying it before a sale takes place. In general, a dividend paid by Farmco to the trust, which is allocated to another corporation, can flow tax-free to that corporation, assuming certain conditions are met. Of note, significant changes to the taxation of inter-corporate dividends were proposed by the 2015 federal budget. You should always be seeking the proper professional advice with respect to the taxation of inter-corporate dividends.

Maximizing government programs

The federal and provincial governments offer many programs and incentives to allow farm families to plan smart. Programs include AgriStability, AgriInvest, Agri-Advisor, Registered Education Savings Plans (RESP), Registered Retirement Saving Plans (RRSP), Registered Disability Savings Plans (RDSP) and Tax Free Savings Accounts (TFSA). The federal and provincial governments have established the Next Generation program to assist young farmers in obtaining the necessary professional advice when considering succession and estate planning. The federal and provincial government will reimburse farmers who are aged 18 to 39 up to $5,000 (50 per cent) of approved professional fees for succession and tax planning, farm business setup or reorganizations. For more information, please contact your local Manitoba Agriculture GO Office.

One relatively new program, the RDSP provides that anyone eligible for the disability tax credit is an eligible beneficiary of an RDSP and contributions made will be matched by a federal grant and a Canada Disability Savings Bond. You may contribute $1,500 and the government may contribute as much as $4,500. The federal government has announced it will allow a tax free transfer of RRSPs on the death of a spouse or common-law partner to a disabled child or grandchild.

The TFSA allows Canadian residents to earn tax-free investment income. Subject to the 2015 federal budget, Individuals over age 18 can contribute up to $10,000 annually (indexed) for the 2015 taxation year. This increase is proposed to be scaled back to $5,500 annually by the newly elected Liberal government. Note that contributions are not tax deductible, but income earned will not be taxable and withdrawals are tax-free. This plan won't affect other provincial benefits, such as the personal tax credit, the education property tax credit, the school tax credit for homeowners and tenants, the Manitoba shelter benefit, Pharmacare and child-care subsidies. Though the effect seems minor, over a number of years it generates significant tax savings.

Other programs to consider include AgriStability and AgriInvest. Contact Agriculture and Agri-Food Canada or your nearest Manitoba Agriculture GO Office to learn more.

Gifting or selling during your lifetime

One way to estate plan is to gift or sell farm property during your lifetime.

Gifting farm property may be done by transferring property to a spouse or common-law partner, child or grandchild by rolling it over (please see page 30 for more information on the family farm rollover rules).

Selling farm property may be done by transferring eligible farm property and using the capital gains exemption (please see Special tax rules for farmers below for more information on capital gains exemption rules).

Advantages of gifting:

- Gift giving during your lifetime may reduce your estate and save probate fees and legal fees on probate.
- You can control who receives the gift.
- There is no gift tax in Canada however the gift may result in a fair value deemed disposition by the giftor thus triggering tax consequences. In addition, the giftee will also want to be aware of the tax consequences with respect to their adjusted cost base of the property going forward. The deemed disposition may be avoided if a rollover applies.
- Giving a gift may reduce your income by income splitting (as long as it is not to minor children or to a spouse or common-law partner).
- Avoids the possibility of any future succession taxes down the road.
- Gifts are non-shareable with spouse or common-law partners under *The Family Property Act* of Manitoba.

Disadvantages of Gifting:

- You lose control over the asset.
- You lose income generated from the asset.
- You cannot use the capital gains exemption to increase the cost base if you gift.
- If you are gifting to spouse or common-law partner, or to a minor child, capital gains and income will generally attribute back to you under various sections of the *Income Tax Act*.

SOLUTION: sell to a spouse or common-law partner and use your capital gains exemption. Below we will look in greater detail at how farmers may transfer property through a sale and use their capital gains exemption.

Special tax rules for farmers

For definitions of capital gains and the capital gains exemption, please see the definitions section on page 4.

History

The capital gains tax was implemented in Canada on January 1, 1972. Between the years 1972 and 1985, farmers, like other Canadians, were required to pay tax for 50 per cent on capital gains. In March of 1985, farmers were given a $500,000 capital gains exemption (all other Canadians got $100,000) which equated to a $250,000 (50 per cent) deduction. By 1995, the personal $100,000 capital gain exemption was abolished, but farmers were spared. In 1988, the capital gains tax rate was increased to 66.67 per cent and then to 75 per cent taxable in 1990. In the year 2000, the capital gains tax rate was reduced to 50 per cent. In March of 2007, the capital gains exemption increased to $750,000 for qualified farm property and shares of a qualified small business corporation which was again increased to $800,000 effective January 1, 2014 with annual indexing to take place. This took the exemption to $813,600 effective January 1, 2015.

The 2015 federal budget once again increased the capital gains exemption for qualified farm or fishing property to $1,000,000 for dispositions on or after April 21, 2015. This $1,000,000 however is not indexed to inflation, thus the current $813,600 exemption applying to qualified small business corporation shares will eventually catch up to the $1,000,000 for qualified farm or fishing property with inflation.

What is eligible for the capital gains exemption?

Qualified farm property can include the following:

- real property used in Canada for farming by any of the following users:
  - the farmer
  - a spouse or common-law partner
  - child (includes a grandchild and great-grandchild)
  - parent (includes a parent and great-grandparent)
  - family farm or fishing corporation
  - family farm or fishing partnership
  - a beneficiary of a personal trust if the personal trust is the holder of the property at the time of disposition
- shares in your family farm or fishing corporation (see specific requirements below)
- interests in the farm or fishing partnership

- an interest owned by the person where all or substantially all of the fair market value of the property of the partnership was used in active farming (an interest in a family farm partnership is a capital interest that entitles the holder to the $1 million capital gains exemption)

- an eligible capital property used in the course of carrying on a farming or fishing business in Canada (ex: a dairy quota used in a farming business)

In addition, the property must meet two primary tests:

1) the holding period test
2) the usage test

To satisfy the holding period test, a property must be held for a period of at least 24 months immediately preceding the disposition by any one of the following:

- the individual, a spouse, a common-law partner, a child or a parent of the individual
- a partnership that includes an interest in a family farm or a fishing partnership of the individual, the individual's spouse or common-law partner
- if the individual is a personal trust, the individual from whom the trust acquired the property, or a spouse, common-law partner, child or parent of that individual
- a personal trust from which the individual, a child or parent of the individual acquired the property

The usage test requires that to qualify as farm property the property must be used principally in the business of farming by one or more qualified users for either of:

a) a period of at least two years and for those same two years the user(s) must have gross revenue from farming exceed all other sources of income
b) if last acquired before June 18, 1987, farmed for at least five years, not necessarily consecutive, or used in a farming business by any one user in the year of sale

EXAMPLE 12: John bought 1,000 acres of farmland in 1980 for $300,000 and actively farmed it. He sells the farmland in 2015 for $1,000,000. His capital gain is $700,000 and 50 per cent of that capital gain is taxable, so $350,000 is included on his tax return and he claims the capital gains exemption and pays no capital gains tax.

- NOTE: if John fails to declare the capital gain and subsequently claim the capital gains exemption to offset, he may lose the right to the exemption if subsequently audited and may have to pay the tax. In other words, the capital gain must always be reported with the corresponding claim of the capital gains exemption, if available. The mere fact that the gain qualifies for exemption does not allow the taxpayer to avoid reporting the gain in the first place.

Deemed Disposition

A capital gain will occur upon the sale or deemed disposition of qualifying property. Except in the case of a rollover to a spouse, common-law partner or a qualified rollover to a child or grandchild, the following are some examples of what constitutes a deemed disposition (please see the family farm rollover rule on page 31):

- a gift of property
- the death of owner
- property transferred to a trust, corporation or partnership, unless an election is filed under section 85 of the *Income Tax Act,* allowing a farmer to transfer to a corporation or a partnership and defer tax

Shares in the family farm corporation

The sale or transfer of shares in the farming corporation will generally be eligible for the capital gains exemption if they meet the following requirements:

- At the time of the disposition of shares, all or substantially all of the corporation's property must have been used principally in a farming business.
- Throughout any 24 month period ending before the disposition time, more than 50 per cent of the value of the property of the corporation was attributable to property used principally in a farming business.
- An eligible user in relation to the taxpayer must have been actively engaged in the business of farming of the corporation's property.

These rules are complicated. Seek the proper professional advice whenever looking to determine whether shares of a farm corporation qualify for the capital gains exemption.

Tips and traps

- The capital gains exemption is a big gift that may not always be there for farmers, so it would be wise to use it at the first opportunity and to plan to use multiple exemptions of your spouse, common-law partner, children or grandchildren.
- You can gift land, shares or a partnership interest to your children. They must generally hold the property for three years before they can sell and use their capital gains exemption to avoid provisions that would attribute the gain back to the vendor.
- Contact Canada Revenue Agency to obtain your exact capital gains exemption balance, or have your lawyer or accountant assist you. If you are over the age of 65 and you receive old age security, you likely will have old age security clawback because of the gains triggered.
- Claiming a substantial capital gains exemption in a taxation year will likely result in the payment of alternative minimum tax.

- Prior allowable business investment loss (ABIL) claims will grind your ability to claim your capital gains exemption. You won't lose your lifetime exemption room, however you will have to repay the ABIL claim before you can use exemption room.
- If you have cumulative net investment losses, these will also need to be repaid before you can claim any of your available exemption room.

Determining the cost base to calculate the capital gain

To calculate a capital gain on farmland, we have to determine the cost base of the farmland. If property was purchased prior to December 31, 1971, the property is typically valued as if it was purchased on December 31, 1971. The cost base of properties purchased after December 31, 1971, is the price paid plus any capital additions to the property. For property that has been gifted or inherited from a parent or grandparent (the donor), the cost base is generally the donor's cost base. Evidence of the amount claimed on the donor's tax return for the year of disposition is required.

Note: Under certain conditions a farmer's capital gains exemption can be applied in the year of death. When determining the value of gifted or inherited property, keep in mind that this may mean the cost base is actually somewhere between the donor's cost base and the current fair market value of the property.

How can I avoid capital gains tax?

Use the capital gains exemption now. Consult a knowledgeable tax advisor and tax lawyer on how you might plan to most effectively use your and your family's capital gains exemptions.

Maximizing and multiplying capital gains exemptions

You can increase the number of capital gains exemptions available to your family farming business by creating a family trust, or by gifting property.

Following are several examples to answer a few of your questions and illustrate the concept of multiplying capital gains exemption:

- Example 13 – gifting farmland
- Example 14 – selling farmland to spouse or common-law partner
- Example 15 – using a spousal partnership
- Example 16 – selling to a family farm corporation
- Example 17 – selling to children or grandchildren
- Example 18 – selling to spouse or common-law partner or child by life or remainder interest
- Example 19 – sale to outsider
- Example 20 – elect capital gains exemption in year-of-death tax return

EXAMPLE 13: Your capital gains exemption has already been used up and you don't have any left over for your farmland that has increased significantly in value. One solution is that you may gift farmland to children or grandchildren and potentially have them use their capital gains exemption when they sell. Note: to avoid attributing the gain back to you, they must hold the farmland for a minimum of three years before selling.

QUESTION: Do I want to use my child's capital gain exemption?
The capital gains exemption is still available and, while it has increased a number of times in recent years, there is always a chance that the exemption will be reduced or removed entirely. It is generally advisable that you use it while it's available, certainly in arm's length sale situations. A thorough review of your overall situation with respect to many factors, such as whether you have any children active in the farm, is needed to determine the best overall course of action.

EXAMPLE 14: Sell farmland to spouse or common-law partner.

- Sam bought land for $150,000. He has used none of his capital gain exemption to date.
- Sam sells his farmland to his wife Maria, to double the capital gains exemptions available to them to $2,000,000.
- He sells the property to Maria at fair market value of $850,000, and takes back a mortgage from Maria for $850,000.
- For the transaction to be considered bona fide and avoid the attribution provisions, Sam must charge interest at Canada Revenue Agency's prescribed rate of interest and that interest must be paid by Maria annually by January 30 of the year following, or the income from the property will attribute back to Sam.
- Assuming that the conditions are met to avoid the attribution provisions, all future income and capital gain on the farmland will now be earned and attributed to Maria (make sure to consider spouse or common-law partner's outside sources of income).
- Maria can deduct the interest paid to Sam to offset her income.
- Sam was advised by his accountant that he could claim a reserve, because he has not been paid by Maria, allowing him to claim only one-fifth of the capital gain over up to five years to avoid other taxes such as alternative minimum tax and the clawback of his old age security.
- Maria will need a Goods and Service Tax (GST) number which is registered prior to the transaction and she will be required to self assess for GST.

$850,000 - $150,000 = $700,000 capital gain to Sam

$700,000 / 5 = $140,000 offsetting capital gains exemption in each of five years

If some or all property or shares are in one spouse or common-law partner's name, determine capital gains and availability to use the capital gains exemption. For any future gain to attribute to your spouse or common-law partner and double the potential use of the capital gains exemption, you must sell at fair market value, transferring the beneficial ownership of the property. Make sure to get an appraisal or opinion of value. This will also serve as creditor-proofing protection. Any income earned by the property will now be earned by the spouse or common-law partner and the selling spouse or common-law partner has a mortgage to protect his or her equity.

Now all future capital gain accrues to spouse or common-law partner and his or her capital gains exemption may be used on future gains.

Warning: If you gift to your spouse or common-law partner, any future capital gain is attributed back to you. You must charge interest at Canada Revenue Agency's prescribed rate with the payment of that interest made by January 30 of the following year, or the income will also attribute back to you. Also, a gift to a spouse or common-law partner precludes the use of the capital gains exemption on a later sale to the spouse or common-law partner and the ability to use the spouse or common-law partner's exemption.

EXAMPLE 15: Transfer equipment and inventory to a spousal partnership, and then sell partnership interests to corporation.

- Sam and Sara form a spousal farm partnership and roll (transfer at cost base) their equipment and inventory to the spousal partnership receiving partnership interests in return.
- The partnership interests have a cost base of $200,000.
- The partnership operates for a minimum of two years.
- They incorporate a new farming corporation.
- Sam and Sara may sell their partnership interests to the corporation.
- The partnership interests now have a fair market value of $500,000 (mostly made up of grain inventory and equipment).
- Sam and Sara can use their capital gains exemptions to offset the capital gain on the increase in value of the partnership interests at the time of the sale to the corporation by electing under section 85(1) of the *Income Tax Act*.
- Selling partnership interests allows the farmer to access the use of the capital gains exemption on the net value of the partnership, which usually includes equipment and inventory, for which you ordinarily can't use the capital gains exemption. This is because a partnership interest is considered a capital asset.

- The corporation will owe Sam and Sara up to $500,000 in a shareholder's loan, which can be paid to them tax free from the corporation.

Note: Sam and Sara will have to watch for alternative minimum tax and the effect this may have on the child tax credit, Pharmacare or any old age security payments they receive, so they will discuss these potential ramifications with their professional advisors.

TIP: If the gain is over the value of your capital gains exemption, you can elect anywhere between cost and fair market value, so you don't exceed your exemption and have to pay tax. Consult your professional advisors to make these decisions as necessary elections and legal documentation will be required to complete these transactions.

EXAMPLE 16: Sale to a family farm corporation is a good option to use when land values are high.

- Harry and Wendy have a farming corporation. Their farmland is in their joint personal names and is not mortgaged.
- To use their capital gains exemptions, they decide they will sell the farmland to the corporation.
- They obtain an independent appraisal of the land value to determine the fair market value.
- The land is sold to the corporation at fair market value and Harry and Wendy can use their capital gains exemption to offset the increase in value of the land from its original cost. The corporation has a GST number and will self assess for GST on the acquisition of the land.

Harry and Wendy's section of land has a cost base of:	$150,000
Harry and Wendy sell the land to the Corporation for fair market value as per the land appraisal	$1,450,000
Capital Gain	**$1,300,000**

half to each of Harry and Wendy ($650,000 each)

Each will use $650,000 of their $1,000,000 exemption to offset the taxable capital gain they claim on their income tax return. Their corporation will owe them $725,000 each, $1,450,000 / 2 (commonly called shareholder's loans) and they will be able to draw this money out of the corporation tax free whenever the corporation has the ability to pay.

Note: If there was still a personal mortgage on the land, the corporation would assume the mortgage debt and the amount of that mortgage would reduce the amount owing to Harry and Wendy in shareholders' loans. For example, assume there is a personal debt of $450,000 on the farmland. Harry and Wendy in the aggregate will take back $1,450,000 of consideration in the form of the $450,000 of debt assumed along with shareholder loans in the amount of $1,000,000 ($500,000 to each).

Harry and Wendy will want to watch out for the impact of alternative minimum tax and any old age security clawback as a result of the triggering of capital gains on the sale of land to their company. Whether a capital gains reserve is available to Harry and Wendy depends upon the situation and they will need to discuss with their professional advisors.

Remember: Corporations do not have a capital gains exemption; however the shareholders can use their exemptions on the sale of qualified shares in the future. **Note:** An election under the *Income Tax Act* is required to transfer land on a fully or partially tax deferred basis. If no election is filed, the transaction by Harry and Wendy with the corporation will still take place at fair value.

EXAMPLE 17: Sale to children or grandchildren

- John and Mary decide to sell eligible property during their lifetime, such as farmland and shares in the family farm corporation, to their daughter.
- Because the property qualifies for the farm rollover, they can pick a price anywhere between gifting at cost and fair market value.
- They have consulted with their professional advisors who advised them to sell exactly for their remaining available capital gains exemption to use their entire exemption so they pay no capital gains tax.
- Note: This may be done by complete sale or by life interest or remainder interest.
- They take a mortgage back from their daughter (or she could go out and get financing to pay them).

- If John and Mary don't need the money (really intending the property should be a gift), they can bequeath the debt (or whatever remains on their death) in their will without decreasing their daughter's cost base. They cannot forgive the debt during their lifetime or they will undo the transaction and reduce their daughter's cost base to their old cost base. NOTE: Equipment, buildings and eligible capital property (ex: dairy quota) can be rolled to children or grandchildren in a similar fashion as land. Depreciable equipment does not qualify for the capital gains exemption. Typically these properties are transferred at the parents' cost to avoid any income inclusions. Eligible capital property can qualify for the capital gains exemption and a process similar to the process described above may be undertaken.
- When selling farmland, depreciable property or eligible capital property to a child (and grandchild), if you take a mortgage back, you can claim a reserve for up to 10 years if the property qualifies for the 10 year reserve. This is useful to spread out the capital gains over a longer period of time, avoiding alternative minimum tax, and possibly avoiding clawback of old age security and other credits. Consult your professional advisors.
- Note – always remember to be aware of the GST and provincial sales tax implications. While the rollovers exist for income tax purposes to defer tax, in many cases the GST consequences do not receive similar treatment and therefore the indirect tax consequences should always be considered.

EXAMPLE 18: Sale to spouse or common-law partner or child by life interest or remainder interest

- Wendy wants to start estate planning for her farm.
- She is thinking about selling her farmland to her daughter. Wendy, however, has several concerns. She does not want to lose control of the farm and she still needs the rental income. She is also concerned about her daughter's marriage and is concerned the property would be shareable if her daughter and her husband separated.

Solution: Wendy could keep a life interest and then dispose of the remainder interest to her daughter at fair market value, taking a demand promissory note and demand collateral first mortgage on the farmland as security. With this plan, her name will stay on the title for her lifetime, and Wendy can continue to control who the land is rented to, and at what price, and will be entitled to all the rental income for her lifetime.

This method crystallizes the capital gain now, and the mortgage allows for a reserve, if needed, to avoid alternative minimum tax and the clawback of old age security. The mortgage back protects against a family property claim from her daughter's spouse or common-law partner up to the current value of the property and from possible creditors. The daughter is assured she will eventually own the farmland, and legal and probate fees are eliminated when Wendy dies.

Note: This method will require assistance from professional advisors because determining the value of the life and remainder interests is required, unless the property meets certain specific conditions. Special clauses are required in the offer to purchase, to ensure that all future gain goes to the daughter. Wendy's daughter will also have to get a GST number and self assess for GST.

EXAMPLE 19: Sale to outsider.

- Harry has found a buyer for his half-section of farmland. He will be selling at fair market value and using his capital gains exemption.
- This method should be done with advance planning to avoid a tax bill.
- Note: Even if you have capital gains exemption available to be used, you can still have a tax bill if you don't plan properly. It would be wise to seek professional advice on possible alternative minimum tax, clawback of old age security for farmers over age 64, loss of the GST credit, Pharmacare, child tax credit, etc.
- Talk to your accountant about whether you have any **cumulative net investment loss** or any **allowable business investment loss,** because these will have to be repaid before you can access the capital gains exemption.

  TIP: It might be better to sell a quarter-section in December of one year and the other quarter-section in January of the next year to spread the income over multiple taxation years. It may also be an advantage to structure the payments as a mortgage to take advantage of capital gains reserves. Of course, if structuring the sale with a mortgage, there is risk of default by the purchaser that should be considered in the legal agreements.

EXAMPLE 20: Elect capital gains exemption in year of death tax return.

- John passes away. He owned qualified farm property and had unused capital gain exemption.
- His accountant advises the executor of his estate to elect the capital gains exemption in John's terminal tax return (because the capital gain exemption is a lifetime benefit only).

- This allows the qualifying farm property to go to his beneficiaries at an increased cost base. Tax may be triggered depending on the beneficiary. For instance, if the land is willed to John's spouse, the land is automatically transferred on death to the spouse at John's cost. The executor can elect to transfer at fair value, however fair value may be more than John's remaining capital gains exemption, triggering tax. Nonetheless, triggering tax may be the best way to get a cost base increase to the spouse through John's capital gains exemption.
- Note that there is no alternative minimum tax in the year of death, so there is no significant disadvantage to electing the exemption.

The family farm rollover rules

One exception to the presumption of selling property at fair market value is transferring property to a spouse or common-law partner, child or grandchild by rolling it over. This means the property goes to the recipient at the current cost base or undepreciated capital cost. Because the property is disposed of at its cost base or gifted, there is no capital gain.

If the property qualifies for the rollover and you transfer to a child or grandchild, you can pick any sale price between gifting and fair market value. If you pick a sale price above cost base, capital gains or recapture may result.

Note: If a true cost base rollover is undertaken, the recipient child receives the property at the parent's cost base and will have to deal with the capital gain when he or she sells the property or bequeaths it.

Note also that there is a deemed tax free transfer to a spouse or common-law partner during lifetime or on death. If you don't want the tax free rollover to your spouse or common-law partner, you must elect out of the roll and sell at fair market value. On a transfer to a spouse you can gift or transfer at fair market value. You cannot pick a price between gift and fair market value as you can on a transfer to a child or grandchild.

Requirements for a rollover to a child:

1) Must be property eligible for the rollover which may include:
    a. farmland, buildings, equipment and quota
    b. shares in family farm corporation
    c. interest in family farm partnership

2) The property noted above must have been used principally in the business of farming by either the individual disposing of the property or their spouse or common-law partner, parents or children. Remember that parents and children include grandparents or great-grandparents and children. Essentially, what this means is that, for more than 50 per cent of the time, the property was used in a farming business by any combination of the individual, their spouse or common-law partner, parents or children.

   Of note, if the property (ex: land) was owned by the individual but used by a corporation or partnership, this can still qualify for rollover, presuming the corporation or partnership is considered a family farm corporation or family farm partnership.

3) The child must be resident in Canada for tax purposes immediately before the transfer.

   TIP: This is also a way to multiply the capital gains exemptions available.

Note – on a rollover, the child must hold the property for at least three years after the transfer to avoid the attribution provisions.

EXAMPLE 21: Sam does not have enough capital gains exemption available to deal with the capital gain on the value of his farmland.

- Sam will gift the farmland to his daughter, Sally. Sally must own the property for three years, and then she can claim the capital gains exemption on a future sale.
- Note: Sally is entitled to the proceeds of any future sale.

EXAMPLE 22: John and Mary have used all of their capital gains exemption and still personally own three and one quarter sections of farmland. None of their children want to actively farm.

- John and Mary advise their lawyer they intend to sell in three or four years. Their lawyer advises them to gift a remainder interest in their farmland to each of their 3 daughters immediately.
- The daughters each get a GST number and self-assess at fair market value on the transaction so no GST is payable.
- Land transfer tax may apply in Manitoba if the land goes to a non-farming child.
- The daughters execute wills leaving the property back to their parents if they should die. The daughters also execute specific Powers of Attorney, appointing their parents to deal with the land and transfer it at their option.
- The daughters hold title to the remainder interest for three years, then sell and use their capital gains exemption.
- There is no gift tax in Canada, so the daughters are free to gift their parents some or all of the net proceeds of sale, if they so choose.

EXAMPLE 23: Sam's daughter does not want to farm but his nephew does. Can he roll to his nephew?

- The *Income Tax Act* does not allow farm property to roll from uncles or aunts to nieces or nephews, only to children or grandchildren (direct descendants).

While uncles and nephews are not considered related to one another for income tax purposes, and therefore arguably the fair market value deeming provisions do not apply to a gift by uncle to son, care should nonetheless be taken. For instance, the Canada Revenue Agency may, on a subsequent audit or reassessment, use the benefit conferral provisions of the *Income Tax Act* to argue that the purpose of the transaction was for uncle to confer a benefit on the nephew and in this case deem the transaction to take place at fair value for the uncle.

Ways to protect what you have

1) Creditor proofing

Creditor proofing refers to steps you can take to protect your farming assets and property from creditors. There are a number of ways to creditor proof:

- If you lend money to your farming corporation or a child, take back a mortgage or other security. This is important as only secured creditors take priority in a bankruptcy, lawsuit or judgment.
- Set up separate corporations: one corporation to hold the farming assets (Holdco) and one corporation to operate the farm (Opco). If Opco faces creditors in operating the farm or legal liability for an accident, for example, all the farming assets are in Holdco and protected. This is because, for legal purposes, corporations are deemed people separate from one another.
- Make sure you have a unanimous shareholders agreement that contemplates bankruptcy of the corporation's shareholders.
- Use a discretionary family trust as the shareholder of the corporation so that no beneficiary is entitled to any asset. That way, the creditors of the beneficiaries cannot access the trust's resources. Entitlement only occurs when the trustees exercise their discretion and allocate income or capital to the beneficiaries.
- Use limited partnerships or limited liability partnerships. Consult your professional advisors.

2) Liability insurance

To protect against potential liability, the farming corporation should carry adequate liability insurance. Make sure all your assets, including land and equipment, are listed on your insurance policy and update it annually. When amending an insurance policy, it is important to ensure the changes do not contravene the lender's insurance requirements, if any. Consult an insurance professional for advice.

Family property claims

It is important to tax planning and management to consider the implications of family law on the family farm.

Some farmers may delay passing land or farming shares to the next generation for fear of encountering family law issues. Family law considerations include the following considerations:

- support obligations
- rights of a spouse or common-law partner to property
- rights on death
- tax planning on separation and divorce
- the effect of divorce on the principal residence exemption

Under Manitoba legislation (*The Family Property Act*), a spouse or a common-law partner of three years (or common-law partners who have registered their relationship with Vital Statistics of Manitoba) are entitled to make a claim for their share of the family property.

Note that each province has different rules.

The basic principles governing *The Family Property Act* of Manitoba are:

- Marriage or a common-law union is an equal partnership.
- Work done inside the home is equal to the work done outside the home.
- All property acquired during the marriage or the increase in value of property acquired prior to marriage will be equally shared upon separation or divorce, regardless of who owns the property.
- All debts acquired during the marriage are shareable unless incurred for a non-shareable asset.

A key principle is that a spouse or common-law partner is not necessarily entitled to the property itself, but to a monetary payment by virtue of an accounting and equalization of assets.

1) Inheritance and Gifts

Inheritance and gifts are not shareable, nor is the increase in value of those non-shareable assets **unless** the party attempting to assert that they are shareable can prove that they were intended to benefit both parties **or** they were converted into family assets. This can be a big problem for farmers. Consult your lawyer.

For example, if you receive a gift of $100,000 intended only for you and you then apply the money to pay a portion of the mortgage against the family home, the funds have become comingled and are therefore considered a family asset divisible upon divorce.

2) Accounting and Equalization

- Upon marriage or common-law relationship breakdown, each party is entitled to an accounting and an equalization of the value of assets acquired during the relationship and any increase in the value of assets acquired before the relationship commenced.
- Any increase in value of assets acquired prior to the relationship and all assets acquired during the relationship must be accounted for, less debts attributable to those assets and common debts acquired during the marriage. In the case of a divorce, the increase in value of assets acquired pre-marriage is considered from the date of marriage to the date of separation.
- Inheritance and gifts will be excluded from the accounting if it was clear they were intended to benefit the recipient only and they have not become family assets. (Example: John inherits a house and the family uses it as their home. It has now been converted into a family asset).
- Transfers for inadequate consideration to third parties can be reversed by order of the court. This could affect gifts or sales of assets to children at less than fair market value. A spouse or common-law partner must receive independent legal advice and consent to any sale at less than fair market value.

3) Upon Death

- Same as above, a spouse or common-law spouse is entitled to an accounting and equalization of family assets, and may be entitled to even more on death than on separation. Jointly held assets, RRSPs and insurance payable to the surviving spouse or common-law partner are excluded from the spouse or common-law partner's share for the purposes of an accounting on death under Part IV of *The Family Property Act*. The surviving partner may have further rights under *The Intestate Succession Act, The Dependent's Relief Act* and *The Homesteads Act*.
- A spouse or common-law partner who does not get what they would have been entitled to in a family property accounting can make a claim under *The Family Property Act,* effectively overthrowing the will. This can upset an estate plan.

The following examples illustrate family property claims:

- Example 24 – Co-habitation then divorce – treatment of inherited assets
- Example 25 – Divorce – some assets are non-shareable
- Example 26 – Divorce – Treatment of assets received as a partial gift from parents

EXAMPLE 24: In 2000, John owns 1,000 acres of clear farmland worth $1,000 per acre. He starts cohabiting with Mary. John and Mary split in 2010. John's land has increased in value to $2,000 per acre. This represents a $1 million increase in value during the period of their relationship. Therefore, John owes Mary half of the increase in value ($500,000) even though his cash flow hasn't changed at all. However, if the 1,000 acres of farmland were inherited or gifted and John's father had clearly indicated in his will that this gift was intended to benefit John alone, and John rented the farmland out and kept the income separate from the family income, the entire property, including the increase in value, would not be shareable and belong to John alone. But Mary might have a homestead claim, if the couple resided on some of the farmland. The farmland, or some of it, may have been converted into a family asset if they lived on some of it, or if John used the income from the farmland for family expenses or to purchase family assets. Where the family home is located on the farm, Mary might be entitled to half of the increase in value of that of portion of the farmland that is deemed converted to a family asset.

EXAMPLE 25: In 1999, Wendy marries Harry. In 2000, Wendy's mother dies, leaving Wendy 1,000 acres of farmland, with a fair market value of $1,000 per acre, which is rented out by Wendy with the proceeds deposited into her personal bank account. In 2005, Wendy and Harry get divorced, and the land has a fair market value of $1,500 per acre. Wendy does not owe Harry anything for the property or the increase in value because both are non-shareable.

EXAMPLE 26: Peter sells his land to his daughter, Sara, at half the fair market value as part gift. He hopes the land will be protected against family property claims if Sara and her husband ever split up. However, a partial gift is not considered a gift by the courts. Selling land to Sara at half of fair market value would make the **entire** land shareable.

If Peter wants to sell at half of fair market value, he should sell half the land at fair market value, taking a mortgage back, which he can forgive in his will. There will be little equity for Sara's spouse to seize. Peter should gift outright the other half of the farmland which will not be shareable at all.

Other things to remember:

- Note that transfers for inadequate consideration (less than fair market value) to third parties can be reversed by order of the court.

- Have the other spouse or common-law partner consent to a transfer at less than fair market value and get independent legal advice to prevent the transaction from being contested later.
- If spouse or common-law partner does not consent, they have the right to raise these issues on death as well as on separation.
- Encourage children to get cohabitation or prenuptial agreements.
- Don't put gifts into joint names with the child's spouse or common-law partner.
- Get the spouse or common-law partners of children to waive rights under *The Family Property Act* to certain assets at the time of transfer (cottages, family businesses, farmland, etc.) with independent legal advice.
- Make sure children have wills and powers of attorney, and keep gifts and inheritances separate. If commingled, they lose their exempt status.
- Make it clear when a will or a gift is intended to benefit the child only.

Other noteworthy legislation:

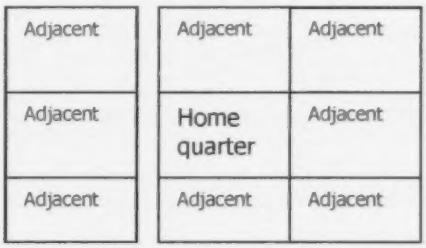
The Dependents Relief Act

- Anybody who was dependent on the deceased can make a potential claim under *The Dependents Relief Act* against an estate. This can upset an estate plan and will.
- One cannot contract out of the right to make a claim under *The Dependents Relief Act*.
- Solution: Make sure your will has a carefully drafted trust clause that provides adequately for a spouse or common-law partner, or dependent or disabled children.

The Homesteads Act

- *The Homesteads Act* entitles a surviving spouse or common-law partner to a life interest in the homestead (the family home). For the purposes of *The Homesteads Act,* a common-law partner of a person means:
  a) another person who, with the person, registered a common-law relationship under *The Vital Statistics Act*
  b) when one person who, not being married to the other person, cohabited with him or her in a conjugal relationship for a period of at least three years.

  Homestead in the case of a farm is the home quarter and any immediately adjacent quarter (up to 320 acres).



- Once a spouse or common-law partner acquires homestead rights, he or she is entitled to remain in the homestead property and have all the income from that property for life. The spouse or common-law partner must also consent to any disposition or mortgage of the homestead property.
- In estate planning, independent legal advice should be obtained by a spouse or common-law partner releasing homestead rights.

To ensure any gifts made in a will are non-shareable under *The Family Property Act,* a special clause should be inserted in your will making this clear. When gifting during your life time, a memorandum of gift with a similar clause is advisable.

Other Tips

- If property is to be kept out of the provisions of *The Family Property Act*, specific care must be taken to exclude it.
- Jointly held property is already shared and not subject to *The Family Property Act.*
- If a farmer owns significant assets prior to marriage, that farmer would be well advised to have his or her spouse or common-law partner sign a prenuptial agreement and contract out of *The Family Property Act* at least as to the pre-acquired assets.
- On separation or divorce, there are many tax planning opportunities if spouses or common-law partners are willing to co-operate.

- Spousal support is tax deductible to payor and taxable to the recipient – good for income splitting.
- Once spouses or common-law partners are formally separated or divorced, there is no attribution of capital gains when transferring to a spouse or common-law partner, thus it allows use of spouse or common-law partner's capital gains exemption.
- Ensure your family law lawyer is knowledgeable in tax issues and drafts carefully, as elections must be filed.

Conclusion

- Smart planning merges the client's goals, anticipation of future problems and good tax planning into one plan.
- Tax planning, creditor proofing and family law proofing are sometimes in conflict, so you must decide which are your main concerns and prioritize. Consult your lawyer and accountant to help you decide.

Making the estate plan

Estate planning takes time, so plan in advance. Smart planning merges your goals, anticipation of future problems and good tax planning into one plan.

Estate planning team

- Talk to your advisors - get written opinions from accountants, lawyers, and other professionals.
- Don't forget to follow up with other estate planning tools – wills and powers of attorney.
- A complete estate plan saves tax, simplifies your estate and gives everyone certainty, but will require an investment of your time and some money.
- Remember to make sure your estate plan is updated as your plans change.

Other Tips

- Remember you are the most important member of the team.
- Ask questions; make sure you understand each and every aspect of the plan.
- Never assume others know what they are doing – don't hesitate to cross-examine team members.
- Be prepared to listen but ask your questions.
- Use experts who believe in the team approach.
- Get the required information to your other professionals.
- Assess farm and business debt capabilities.

- Assess your retirement needs.

What is fair?

- Assess your need or desire to benefit other family members. How should the farm be divided between farming and non-farming children? What is fair?
- Equal is not always fair and don't forget that the farming child may inherit potential tax.

Power of Attorney

Planning for sickness and disability

A power of attorney is a legal document where an individual, the donor, decides to give authority to another person, the attorney, to make decisions regarding some or all of the donor's financial and legal affairs on the donor's behalf. Powers of attorney are only in effect during a donor's lifetime. There is no authority after death.

Practically, what this means is that the attorney appointed can do anything for the donor that is permitted in the power of attorney. Common examples of powers which are given in a power of attorney document would be banking decisions, ability to sign contracts and agreements, ability to sign transfers of land and mortgages and dispose of homestead rights as required, and the ability to settle disputes. Where the donor's spouse is appointed as attorney, an alternate person will be appointed to dispose of homestead rights. For practical reasons, it is often recommended that the donor and attorney reside in the same city.

Types of powers of attorney

Generally, there are two basic kinds of power of attorney: the enduring power of attorney, which takes effect immediately (though need not be used immediately), and the springing power of attorney, which takes effect when the donor becomes incapable of acting based upon the method provided in the power of attorney (example: two doctors' opinions). It is important to note that, so long as the donor is mentally competent, either power of attorney may be revoked. This is an important protection.

One of the main benefits of a power of attorney is that it circumvents the family having to make costly applications to the court to appoint someone to be in charge of an incompetent person's property or health (committeeship).

Springing power of attorney

A springing power of attorney is a document that only comes into force and effect upon some future event, usually the incapacity of the donor. A springing power of attorney has the practical advantage of allowing the donor to feel secure that he or she has appointed an attorney that they know and can trust to manage their affairs when and if they become incompetent, instead of relying on a court decision appointing someone. Most importantly, the springing power attorney allows the donor to live with the peace of mind that no one can conduct any business on his or her behalf unless and until he or she becomes mentally incompetent. The disadvantage is that decreased capacity is often not easy to pinpoint and a great deal of uncertainty can result as to when a springing power of attorney becomes activated. You may not be incompetent but you may not be competent enough to manage your business affairs.

Enduring Power of Attorney

An enduring power of attorney is a document that comes into full force and effect upon being signed by the donor. As with all powers of attorney, the enduring power of attorney may be either narrow or wide in the powers it grants the attorney. In addition, an enduring power of attorney can specify whether or not the donor wants the document to continue to be enforced after the person has become mentally incompetent.

The benefits the enduring power of attorney offers include the fact that the person appointed may immediately look after the affairs of the donor. An enduring power of attorney provides for the donor in case of accident, temporary illness or long term incapacity but also has inherent risks. For example, the person appointed could make an unlawful unauthorized use without the donor's knowledge. All attorneys stand in a fiduciary capacity. This means they can only act in the donor's best interest and cannot benefit themselves personally. An attorney who abuses his or her duty, can be challenged and removed, and potentially face criminal charges. An enduring power of attorney should only be granted to someone you have complete trust and confidence in. You may consider appointing more than one attorney, to reduce the risk of abuse or appoint a recipient of accounting, someone who can demand to see an accounting from your attorney, to police your attorney.

Legal requirements of a power of attorney

First and foremost, for a power of attorney to be valid, the donor must be mentally capable of understanding the nature and effect of the document when it is created. In addition, the enduring power of attorney must be in writing, be duly executed and witnessed.

There are specific execution requirements for an enduring power of attorney.

Currently the law requires that the witness for an enduring power of attorney must be a lawyer, a notary public, an RCMP or municipal police officer, a physician, a judge, a justice of the peace or magistrate, or a person authorized to solemnize marriages in the province.

A springing power of attorney only comes into effect once the event specified occurs, in many cases, once the donor has been declared mentally incompetent by two qualified medical doctors. Therefore, following a triggering event, if the donor regains competence, the donor can revoke or suspend the power of attorney. However, in such cases, the donor must clearly advise all parties who may rely on the attorney document of this decision.

Executing a power of attorney is a wise course of action that can only be taken while the donor is still mentally competent. Aging individuals who begin to lack ability to manage their affairs should in particular consider the appointment of a power of attorney to help them deal with their financial affairs. In addition, the larger and more complex the estate of the individual, the more appropriate a power of attorney becomes. Do not try to draft a power of attorney yourself without your lawyer.

Reasons for making a power of attorney

Powers of attorney allow you to choose who will manage your property, finances and personal affairs for a specific or extended period of time. They help to plan for a time when you may not be able to make decisions on your own. This often provides peace of mind for you and those you care about.

A power of attorney is a document of trust and faith in the individual who is being named the attorney. It is also a document of great power. Therefore, if the individual you are naming or his or her spouse or common-law partner is someone that you cannot fully trust, then you should be naming someone else, or you may need to consider appointing an outside party.

Common Concerns and Frequently Asked Questions about Power of Attorney

Who can be appointed as an attorney?

The attorney must be an adult, with mental capacity, and not an undischarged bankrupt. *The Powers of Attorney Act* allows for the appointment of any number of attorneys to act jointly or successively. If the document is silent as to the type of appointment, then the attorneys will act successively in the order in which they are named in the power of attorney document. In addition, *The Powers of Attorney Act* sets out the following guidelines. These guidelines will be used unless specifically stated otherwise in the power of attorney document.

1) When the attorneys are appointed to act jointly, the decision of the majority is deemed to be the decision of all, unless otherwise specified.

2) If there is no majority, then the first named attorney will make the decision for the group, unless otherwise specified.

3) If one of the attorneys disagrees with the decision of the other, he or she will not be liable for the consequences of the decision if he or she do not vote or consent to it, and provides a written objection to each of the other attorneys as soon as reasonably possible after learning of the decision.

4) When making your power of attorney you should consider at the very least, the following:

    a) whether you will name one or more attorneys, and whether they should act jointly or successively

    b) whether there will be an alternate attorney(s)

    c) whether or not your attorney will be paid for acting on your behalf

    d) whether or not your attorney will be given broad or limited powers

    e) whether you will provide another named individual the ability to request and receive an accounting from the attorney by naming this person as the recipient of accounts in your power of attorney, as well as the frequency of such requests

    f) an alternate attorney if you name your spouse or common-law partner as your principal attorney, because a spouse or common-law partner cannot act as your attorney with respect to the disposition of homestead property

    g) including a specific clause that allows your attorney to deal with real property is required by the various legislative enactments concerning real property in Manitoba; otherwise a Manitoba Land Titles Office cannot accept the power of attorney document

Accountability of the attorney

The *Powers of Attorney Act* sets out the duties and accountability of an attorney. First, all attorneys are required to act in the best interest of the donor. The standard of care of the attorney changes depending on whether there is compensation payable or not.

An attorney who does not receive compensation for acting as an attorney shall exercise the judgment and care that a person of prudence, discretion and intelligence would exercise in the conduct of his or her own affairs.

However, an attorney who receives compensation for acting as an attorney shall exercise the judgment and care that a person of prudence, discretion and intelligence in the business of managing the property of others is required to exercise.

The Powers of Attorney Act also allows the donor to appoint a person to whom the attorney must account on demand, called a recipient of accounting. If no such person is named, then the attorney must account annually to the nearest relative as defined in *The Powers of Attorneys Act*.

No person who receives an accounting has any duty or liability in respect of the accounting.

Termination of power of attorney

A power of attorney is terminated by:

1) appointment of a substitute decision-maker for property appointed for the donor pursuant to other legislation
2) appointment of a committee of the estate
3) bankruptcy of the donor
4) bankruptcy, mental incompetence or death of the attorney
5) death of the donor
6) renunciation of the appointment by the attorney in accordance with *The Powers of Attorney Act*
7) termination by a court

If I have no power of attorney, can my family or friends apply to handle my affairs if I am incapacitated?

If you are incapacitated and you have given no one power of attorney, your family or friends can apply to the Court of Queen's Bench for an order of committeeship to manage your financial affairs and personal care. Two doctors will have to provide affidavits as to your incapacity. This is an expensive and time-consuming process.

The person applying for a committeeship must live in Manitoba and more than one person may be appointed to act jointly or as alternates.

Committeeship

Once an individual has obtained a committeeship order, he or she may manage your affairs (depending on what is granted in the order). He or she will be required to bring an accounting to the court every two years (or as the court orders) as to the monies received and disbursed on behalf of the incompetent individual. The cost of this is generally paid for out of the monies of the incapacitated person. This is an expensive and time-consuming process.

What happens if no one applies to handle my affairs if I am incapacitated?

If no one applies to handle your affairs upon your incapacity, the Public Trustee of Manitoba may step in and obtain an order of committeeship. They will govern your financial and personal care and be paid a fee for their services out of your assets.

Health care directive or living will

What is a health care directive or living will?

A health care directive is a document that permits the maker to set out his or her wishes concerning medical treatment they do or do not want administered when they are no longer competent. The maker can use it to appoint a person called a health care proxy to make health care decisions for them.

Health care directives also referred to as living wills can include instructions about therapeutic, preventative, palliative, diagnostic, cosmetic or other health related matters involving any course of treatment. They can be used to turn down life prolonging treatment, palliative care, nutrition or hydration.

Who can make a health care directive?

To make a health care directive, one must be competent to grant or refuse consent to current medical treatment. An individual is presumed to have capacity if he or she is over the age of 16, but this presumption is arguable. A person is competent to make health care decisions if able to understand information relevant to the decision and able to appreciate reasonable, foreseeable consequences of a decision or lack of same. If evidence to disprove capacity can be provided, then a health care directive could be held to be invalid and overturned.

Requirements and considerations

Health care directives must be written, dated and signed by the maker of the health care directive. The health care directive need not be witnessed. Oral health care directives are **not** allowed because having one person recall oral instructions from another is considered unreliable.

Health care directives must be brought to the attention of health care providers.

Lawyers often suggest that upon making a health care directive, that you provide a copy to your doctor and to your local emergency room hospital for placement in your file in the event that your require immediate treatment and you are unable to provide instructions to your health care provider. Paramedics often suggest that you leave a copy of your health care directive somewhere visible in your home, such as on your refrigerator.

Proxy

To act as a proxy, a person must be at least 18 years of age and mentally competent. Otherwise, you are free to choose whoever you believe will properly represent you. The proxy must know your wishes, values and beliefs. The proxy should also consent to act in advance of being named. This will avoid undue complication in times of medical emergency.

The health care directive allows the proxy access to your medical information so that he or she can make an informed decision. You should discuss your medical information with your proxy at the time of making your health care directive so that he or she clearly understands why you have chosen certain medical treatments or rejected others.

Some may want to appoint more than one proxy. If more than one proxy is appointed, they normally act successively in the order they are named. Should the first person named be unable or unwilling to act, the next named person may step in. A health care directive may also specify that proxies act jointly. If proxies act jointly, then the majority decision is the decision of the group unless unanimity is required under the health care directive. In the event of a tie, the first-named proxy can break the tie. If one or more is unwilling or unable to act, then the remainder can act and the majority of the remainder is the decision of the group. You should carefully consider the advantages and disadvantages of these scenarios in determining whether you wish to appoint more than one proxy.

Frequently Asked Questions about Health Care Directives or Living Wills

When does a health care directive come into effect?

A health care directive comes into effect when the maker does not have capacity to make decisions with respect to a proposed treatment. This is usually decided by a medical doctor. In addition, a maker may be unable to communicate his or her wishes. A health care directive will continue in effect for the duration of the incapacity or inability to communicate.

Can a health care directive be revoked?

You can change your health care directive at any time as long as you are still competent to do so. You can cancel or revoke a previous health care directive in one of three ways:

1) if you destroy every signed copy of the health care directive either personally, or by giving instructions to another person on your behalf

2) if you make a new health care directive that is dated after your original health care directive

3) if you declare in writing your intention to revoke the directive and such declaration is executed in a similar fashion to a health care directive

Life Insurance

Life insurance is an important estate planning option to ensure spouse or common-law partners and minor or disabled children are adequately provided for. Life insurance may also be useful to equalize between children when one child is going to be continuing the family farm.

The insured individual may make a designation in the contract of insurance, by declaration or by will. Any later designation renders the designation in the will ineffective, or if the will making the designation is later revoked, so is the designation. You can also name a trustee for the beneficiary while keeping the proceeds out of probate and free from the claims of creditors. You can designate a beneficiary irrevocably, which precludes you from changing the designation without the beneficiary's consent.

Life insurance allows you to avoid the claims of creditors if the beneficiary is someone other than your estate. The proceeds do not form part of the estate and pass directly to the beneficiary. Sometimes it is advisable to make life insurance payable to your estate to ensure your spouse or common-law partner or a spouse or common-law partner of a later marriage cannot make a claim against assets being left directly to children. Oftentimes, life insurance proceeds may be used to redeem the shares of the deceased in a corporation. Expert legal advice is required to make this decision.

Consult your financial advisor as well as your lawyer as to whether the farming corporation should obtain the policy as well as be the beneficiary of the policy.

ESTATE PLANNING FOR FARMERS

Making a will

What is a will?

A will is a written document that directs what happens to a deceased's property and assets after death. A will also directs who will administer your estate. A person who makes a will is known as a testator.

A will takes effect or speaks at the moment of death. However, signing a will does not prevent the disposal of assets during a person's lifetime.

Often people believe that they do not require a will because they hold joint title to all assets with their spouse or common-law partner and they have life insurance naming each other as the beneficiaries. However, there are a number of good reasons for executing a will:

- Wills are a valuable tool for estate planning and saving tax.
- Wills set out a person's personal wishes as to what should happen to his or her estate on death or in the event of a joint death.
- There could be unexpected costs related to not having a will in place.
- In particular, farmers are wise to have wills to deal with farming assets in as tax efficient a manner as possible, to give powers to your executor to file a separate tax return for your inventory, to allow your executor to elect your capital gains exemption and to perform a tax reorganization after your death.
- Without a will, problems can arise if promises were made by a testator before death.
- Wills provide a means of benefitting non-blood relations, such as close family friends, which would not be permissible without a will.
- Wills provide direction to your spouse or common-law partner as to what should happen when the surviving spouse or common-law partner dies.

Mutual wills

Mutual, reciprocal or mirror wills are separate wills of each spouse that are virtually identical and are common with farmers. Case law has held that if a couple make this type of will and then one spouse dies and the survivor changes his or her will the courts may invalidate that new will by finding a binding agreement based upon the first will. A lawyer who drafts a reciprocal will cannot draft a new will for either spouse without the consent of both spouses unless the parties have separated.

Legal requirements of a will

A person making a will must be at least the age of majority and must be competent to make the will. A will must be in writing, and prior to signing, the person making a will should initial any written changes and initial the bottom of every page of the will to confirm that he or she understands the intentions of the document. For a typed will to be valid, it must be signed by the testator in the presence of two witnesses, who must each sign the will in the presence of the other witness **and** the maker of the will, and who must also each initial the bottom of every page of the will. The witnesses cannot be beneficiaries or the spouse or common-law partner of a beneficiary.

One of the witnesses to the will must swear an affidavit that the court will consider upon an application for probate. The affidavit contains statements relating to the belief that the person making the will was competent to understand the terms of his or her will, that both witnesses to the will were not beneficiaries or the spouse or common-law partner of a beneficiary, and that the person making the will was at least 18 years of age.

For a will to be valid, a testator must have testamentary capacity. Testamentary capacity will be found if the testator understood the nature and extent of the acts and its effects; understood the extent of the property being disposed of; understood, comprehended and appreciated any legal obligation the testator may have to others; and has no mental disorders. Further, the testator must not be under any undue pressure, threat or stress from others.

If any one of the legal requirements for making a formal will is not met, a possible challenge to the validity of the will can be made. This will result in significant delay and expense in the proper administration of the estate.

A valid will can be created without the assistance of a lawyer. However, assistance from a lawyer is very beneficial and will help prevent problems relating to a person's estate after death. Lawyers have the responsibility to ensure that the testator is aware of all legislated requirements at the time of execution of the will. The following is a brief overview of typical information that is required so a lawyer can adequately prepare your will:

1) your full legal name
2) your address and occupation
3) the full legal name of your spouse or common-law partner (if applicable)
4) the full legal names of any children
5) the full legal names of any other person named in your will and, if applicable, alternate names that any person may be known by (this can avoid later problems of attempting to prove who such other people are)
6) the relationships of all people in your will
7) your marital status – and whether you will be contemplating marriage, divorce or separation around the time of making your will

8) the location of any assets or property that you own – specifically if they may be located in another jurisdiction
9) a list of all personal property and real property that you own and approximate value
10) a list of all jointly owned assets that you own and the name of the person with whom you own them
11) the full legal name of your executor(s) and any alternates
12) the full legal name and address of any charity to whom you wish to benefit
13) whether any of your children or grandchildren are adopted or are step-children or are born outside of marriage
14) whether any of your children or grandchildren are mentally or physically disabled
15) whether you have any liabilities and the names of such creditors
16) whether any person owes you money and whether this debt, if remaining at the time of your death, will be required to be repaid to your estate
17) a consideration to the types of powers that you wish to give to your executor(s) such as: the power of sale, the power of investment, the appointment of agents, the postponement of sale, the power to carry on business, the power to mortgage property to raise funds, the power to exercise voting rights, the power to distribute a portion of the estate without the item being required to be converted into cash, and any other powers you wish to give to your executor(s)
18) whether or not you wish your executor(s) to be able to be paid a compensation for their services
19) whether or not minor beneficiaries are to receive any portion of the estate prior to reaching the age of majority, or whether distribution of their portion is to be delayed until the beneficiary reaches a certain age or ages
20) whether you have an obligation to someone who is dependent on you
21) whether you have signed any prenuptial, cohabitation or shareholder agreements
22) the particulars of your life insurance
23) how you want your assets distributed and why
24) any homestead rights a spouse or common-law partner may have
25) the particulars of any unanimous shareholders agreement(s) you may have signed.

Reasons for farmers to have tax planned wills

Farmers can plan their wills to save in tax. Everyone is deemed to dispose of all their property at death and must pay tax on any capital gains or recapture. There are some exceptions to this rule.

1) Rollover to a spouse or common-law partner (sections 70 and 73(1) of the *Income Tax Act*).
2) Rollover of qualified farm property to children, grandchildren or great-grandchildren (sections 70, 73(3) and (4)).

Farmers have a wide variety of options to plan their estates in a tax efficient manner.

1) Make maximum use of capital gains exemption

If a farmer has a capital gains exemption balance remaining at his or her death, the trustee of the estate may elect to use the deceased's capital gains exemption in the year of death. This will allow the beneficiaries of that asset to receive the asset at an increased cost base and save tax.

To allow the use of the capital gains exemption in the year of death, a similarly worded clause should be inserted in the will:

> I authorize my Trustee to make any election which is available to my Trustee, which, were I alive, would be available to me under any section of any taxing statute, whether federal, provincial or foreign. I further authorize my Trustee to appoint further Trustee(s) or to effect any post mortem reorganization or planning as they may deem expedient and in my and my estate's best interest.

2) Make maximum use of rollover rules if your capital gains exemption has been used up

If your capital gains exemption is already used up, it is wise to plan accordingly in your will to allow for property to roll to a spouse or common-law partner, children, grandchildren or great-grandchildren to avoid capital gains tax. This means the property goes to the spouse or common-law partner, children, grandchildren or great-grandchildren at the current cost base or at undepreciated capital cost. Because the property is transferred at the cost base, there is no capital gain on your death.

Under sections 70 and 73(1) of the *Income Tax Act*, you can transfer RRSPs and capital assets tax free to your spouse or common-law partner and defer any taxes to your spouse or common-law partner until your spouse or common-law partner sells or dies. Special wording is required.

See the family farm rollover rules (31) to determine if your farm assets qualify for a roll to a child, grandchild or great-grandchild.

Note: The beneficiary receives the property at the low cost base and will have to deal with the capital gain or recapture when they sell the property down the road.

If specific gifts are not made in the will, make sure the trustee has the power to roll assets to the residuary beneficiaries and that the will is worded to allow those farm assets to vest indefeasibly to your children within 36 months of your death. Consult expert legal advice, as special wording is required in your will.

3) Elect grain or animal inventory in a separate rights and things return

Section 70(2) of the *Income Tax Act* allows the deceased's executor to elect to file a separate tax return with a separate set of personal tax credits and lowers marginal rate of tax. In the year of death, for inventory, this election alone could save significant tax to your estate.

If the deceased was an employee who owned shares in a corporation, a $10,000 tax free benefit can also be declared in the year of death.

4) Spousal trust

One way to provide for a spouse or common-law partner is to use a spousal trust in the will. This generally provides that the estate or portion of estate is invested in a trust by the trustee selected by the testator for the sole and exclusive benefit of his or her spouse or common-law partner, during the spouse or common-law partner's lifetime by the trustee of the trust. Income earned by the trust may be paid to the spouse or common-law partner, at the discretion of the trustee. No income or capital can be paid to anyone else until the spouse or common-law partner's death.

The trust is a separate entity from the spouse or common-law partner and files a separate tax return, and therefore allows income to be split between the spouse or common-law partner and the trust.

As the spouse or common-law partner has no entitlement to the trust or income from the trust, the spouse or common-law partner may not be receiving what he or she is entitled to under Manitoba family property legislation. Therefore, before proceeding, the spouse or common-law partner should receive independent legal advice and sign an agreement waiving his or her rights under family property legislation. A solution to this problem is to leave 50 per cent of your estate or exactly to the spouse or common-law partner's entitlement under *The Family Property Act* and 50 per cent in a spousal trust.

One reason for a spousal trust is to protect the capital assets, for example, the farm for the children who want to farm, and yet still provide adequately for your spouse or common-law partner. If you leave everything only to your spouse or common-law partner and then your spouse or common-law partner sells the farm or remarries, the farm may not be available to your farming children.

Note that a spousal trust's income will now be taxed at the highest marginal tax rates, so the benefits to using such a trust would not be tax-related.

Another option is to transfer the farm to your farming children by gifting or selling during your lifetime. (See page 20)

5) Trust for disabled or special needs beneficiaries

A special trust can be set up to provide for disabled or special needs beneficiaries. The trust is set up in the will for the benefit of the disabled or special needs beneficiary. The estate or portion of estate is invested in a trust by the trustee selected by the testator for the sole and exclusive benefit of the disabled or special needs beneficiary. Income earned by the trust may be paid to the disabled or special needs beneficiary at the discretion of the trustee. Capital may also be paid at the trustee's discretion. This is an important provision to protect current funding the disabled or special needs beneficiary might already be receiving from other sources, especially government programs. As long as the beneficiary is not entitled to receive anything under the trust, his or her current social benefits should not be affected.

The trust is a separate entity from the spouse or common-law partner and files its own tax return. At the end of 21 years, the trust will be deemed to dispose of its capital assets and pay tax at that time. When the beneficiary dies, the will provides direction for what happens with the capital left at that time. This type of trust can also be used to protect spendthrift beneficiaries and provide a stable income for them until their death. Often, the trustee has the discretion to collapse the trust if a disabled or special beneficiary recovers.

Common Questions about Wills

What happens if assets given in a will have already been disposed of at the time of the testator's death?

If a testator has provided for a gift of a certain specific asset in his or her will and that asset is disposed of by the testator prior to his or her death, the gift will no longer be part of the estate. Unless the testator provides for an alternate gift in that situation, the beneficiary who was to have received that gift will receive nothing.

For example, a farmer who leaves his farmland to his son in his will and then sells it before his death should amend his will to prevent his son from receiving nothing. A will should provide for an alternate gift, for example, the sale proceeds of the land, if the land is sold prior to death.

What happens if I die without a will?

Without a will, a person who may administer your estate may not be the person you would have chosen otherwise. Your estate will automatically be distributed according to *The Intestate Succession Act* of Manitoba. You will also not be able to take advantage of the tax saving opportunities and elections. Powers you would grant to your trustee in your will would not be available and extra legal costs and bonding company fees may apply. Certain charitable gifts and the forgiveness of debt can only be done by a will.

If there is no will or if the will has caused intestacy because a beneficiary has predeceased a testator, then the distribution will be governed by *The Intestate Succession Act*. In this case, a deceased person's wishes are not considered.

Distribution is all to a spouse or common-law partner, if there are no children from a prior marriage or relationship. If someone dies leaving a surviving spouse or common-law partner and children, and one or more of the children are not also children of the surviving spouse or common-law partner, the share of the surviving spouse or common-law partner is both of:

(a) $50,000, or one-half of the intestate estate, whichever is greater

(b) one-half of any remainder of the intestate estate after allocation of the share provided by clause (a).

If there is no surviving spouse or common-law partner, distribution is made to the children and their descendants, then to parents of deceased and their descendants, then grandparents and their descendants.

What happens if the spouse or common-law partner has already died?

If the testator has no spouse or common-law partner, the estate would go to the testator's children equally.

What if I have no blood relations?

If the testator has no blood relations, the estate would go to the Crown – the Government of Canada. This is rare. Usually there are distant relatives. However, tracking those people down and distributing very small shares is expensive and will not accomplish what the deceased desired to happen. Certainly, it will make it difficult for anyone to take over the farm.

What happens if a couple is living apart at the time of death?

If a couple is living apart at the time of death, but not formally separated, the current will of the deceased still applies. Even if the couple is formally separated, the will is still valid and operative. Only upon divorce is any gift to a spouse or common-law partner or appointment of a spouse or common-law partner as trustee void.

Therefore, upon separation, parties should immediately prepare new wills, health care directives and powers of attorney.

Can a spouse or common-law partner be disinherited?

Spouse or common-law partners are normally required to provide for their spouse or common-law partner in their will. If they fail to do so, the surviving spouse common-law partner may make a claim under Part IV of *The Family Property Act* of Manitoba for an accounting and equalization of all assets acquired during the marriage. This part gives far more to the surviving spouse or common-law partner than if the parties separated and a claim was made. To opt out of this provision, parties may enter into a spousal agreement, waiving their rights to claim under the *Family Property Act*. Independent legal advice is required by each partner.

A spouse or common-law partner may also make a claim under *The Dependents Relief Act* for support.

What if a will does not adequately provide for a dependent family member?

If a will does not adequately provide for a dependent family member, anybody who was dependent on the deceased can make a claim against the deceased's estate under *The Dependents Relief Act*. This can upset an estate plan and will. One cannot contract out of the right to make a claim under *The Dependents Relief Act*. Solution: Make sure to provide adequately for a spouse or common-law partner, or dependent or disabled children in the will. Your lawyer can help you sort these issues out.

Can a person cut their adult child out of their will?

As long as adult children are not dependent on parents, the parents may choose not to benefit all or any of their children in their wills. It is now quite common for parents not to distribute their estate equally to their children.

What happens if both spouses or common-law partners die at the same time?

The Survivorship Act of Manitoba lays out what happens in this type of situation. If it is uncertain who dies first, the deceased's property will be deemed disposed of as if each spouse or common-law partner survived the other. However, if one spouse or common-law partner survives the other by hours or minutes, they will take from the other spouse or common-law partner and the will of the second spouse or common-law partner to die will prevail. Often lawyers will draft wills requiring the spouse or common-law partner to survive by 15 to 30 days before they inherit under the other spouse or common-law partner's will.

How often should I update my will?

Your will should be reviewed every few years. If you want to make changes to your will, you have two options: first, a new will can be drafted revoking all previous wills. This is preferred if the changes contemplated are extensive and it would be easier to understand if a new will was made. Second, a codicil can be drafted to your original will which would make changes to the will, adding to the will or revoking particular gifts or appointments in the will.

The codicil would also affirm the remainder of the will. The formal codicil must be executed like a will with two witnesses to the signature and an affidavit of execution.

You should **not** cross out sections of your will or write changes directly on your signed will. If you must make changes to your will, they should be made as set out above by a having a new will or codicil made. If changes are not made correctly, your will may be declared invalid.

You should also review the terms of your will upon the existence of circumstances including marriage, separation, divorce, birth of a child and establishing a common-law relationship. For example, marriage nullifies any prior will, while divorce **does not**. You should consult with a lawyer to learn more about such circumstances.

What is an estate trustee or executor?

An estate trustee or executor is someone who oversees administration of your estate. A benefit of having a will is that you can appoint an individual or individuals you trust. Trustees apply for a grant of probate of your estate, pay creditors from the proceeds of your estate, file your tax return, pay your income taxes and distribute the estate according to your will.

What are probate and administration?

Probate is the process of applying to the Court of Queen's Bench of Manitoba to formally affirm the validity of the will and issue a grant of probate appointing trustees or executors of the estate as named in the will.

If an individual died without leaving a valid will, a spouse, common-law partner, family member or friend can apply to the court for letters of administration granting the power to deal with the estate of the deceased. Generally, consent from those with equal or closer connection to the deceased will have to be obtained. If administration of the estate is required where a will is not made, administrators of the estate, unlike executors, must often provide some form of financial security or bond where an estate is valued over $50,000. This could result in a heavy financial burden to the estate and is time consuming.

What are a lawyer's fees for settling an estate?

The fees a lawyer may charge are set out in Court of Queen's Bench rules or by agreement of the executor and residuary beneficiaries, who must all sign a form agreeing to the lawyer's fees or approval of those fees by the court. The Court of Queen's Bench legal fee guideline was recently amended and came into force on January 1, 2013. The fees are intended to be a percentage of the value of the estate assets. Remember that estate assets do not include property held in joint tenancy or such things such as RRSPs, pensions, insurance or annuities that are not payable to the estate (though other fees may relate to these assets). Legal fees for an estate of average complexity are calculated on the basis of the total value of the estate as follows:

- three per cent on the first $100,000, or portion of that amount, of the total value of the estate, subject to a minimum fee of $1,500
  one and one-quarter per cent on the next $400,000, or portion of that amount, of the total value of the estate
- one per cent on the next $500,000, or portion of that amount, of the total value of the estate
- one half per cent on the total value of the estate over $1,000,000
- a lawyer may be entitled to additional fees depending on the complexity of the estate, whether estate assets are sold, or whether the lawyer helps with the assets not included in a will or probate
- the lawyer's fees are always subject to review by the courts

What are the probate or administration fees?

Probate or administration fees are payable according to the value of the estate. An estate trustee or administrator must pay $70 for the first $10,000, plus $7 for every $1,000 thereafter.

Examples: Estate worth $100,000 → $700 probate fees.
Estate worth $2,000,000 → $14,000 probate fees.

A probate calculator can be found on the Manitoba Justice web pages at ProbateCalc

How is a will contested?

Occasionally, circumstances arise where it is apparent that there is going to be a dispute between a party putting forth a will for probate, and someone who challenges the validity of that will and the right to probate it. There are a number of reasons for such disputes, but they most often fall under the following categories:

- It is contended that the will has been improperly executed.
- It is contended that the testator lacked testamentary capacity at the time of the making of the will.
- It is contended that the execution of the will was brought about by undue influence or fraud.

In cases where the validity of a will is challenged, it becomes the responsibility of the executor to file a notice of application to prove the will in solemn form, a court proceeding that requires notifying all interested parties.

A person intending to oppose the issue of a grant of probate or administration may also file a caveat in the courts at any time before the grant is issued. A caveat is a notice in writing requesting that the registrar not allow anything further to be done in the estate without the party filing the caveat being given notice of further proceedings. The caveat remains in force for 12 months, but may be renewed by re-filing. When a request for probate is filed, however, it will cause the registrar to serve notice calling upon the caveator within 30 days after service to make an application pursuant to the caveat, failing which the caveat will be cancelled. Note that a caveat cannot be filed if probate has already been issued.

Applications may also be made for a number of other reasons. For example, applications might be made for orders to:

- accept or refuse probate or administration
- bring in testamentary paper
- bring in a grant for revocation
- account for the deceased's property
- pass the accounts of the estate trustee

Legal advice should be sought to determine whether an application to contest the will should be made.

What happens if a will is declared invalid?

If a will has small irregularities or only a copy can be found, it may be admitted to probate as a near will by approval of the court upon application. Alternatively, a will may be contested if:

- The testator is proved to be incompetent at the time of the making of the will.
- The court is satisfied that the testator was under the influence of others.
- The will does not provide adequately for a spouse or common-law partner or other dependent.
- The will is so vague it is void for uncertainty.

All these examples demonstrate why it is important to have a competent lawyer draft your will.

Joint Assets

When property or assets are held jointly, upon death, the right of survivorship applies and the surviving owner becomes the owner of the property of the deceased. Example: farmland held jointly with spouse or common-law partner. Such joint property is excluded from the value of probate and no probate fees are paid, which is one reason why owning property jointly is attractive to a spouse or common-law partner. The other is to gain the advantage of two capital gains exemptions.

Joint assets with children

Caution must be taken in placing assets in joint names with someone other than your spouse or common-law partner. The Supreme Court of Canada has ruled that just because bank accounts are labelled joint, it does not determine who is entitled to them upon the death of one of the account holders. Whether the surviving bank account holder will be solely entitled to the assets depends upon the intention of the deceased, as well as whether the other joint asset holder was a spouse or common-law partner or a child.

EXAMPLE 28: A joint bank account is held by a mother and daughter to allow the daughter to assist her elderly mother with her banking. All the money deposited into the account is the mother's. The mother makes a will leaving everything equally to her two children.

In this situation, whether the daughter, who is the other joint account holder is entitled to all the money in the account after the death of the mother depends on the intention of the mother. In many such situations, the courts will find that the daughter held the monies as trustee for the mother. This is because there is a presumption in law that, in this type of situation, the monies were to be held in trust and that the mother intended the daughter should share with her other siblings. As a result, probate fees should be paid on that bank account as it is held in trust for the deceased.

With so many elderly individuals transferring assets into joint names with their children, the courts have recognized that this is often set up for such individuals to be able to receive help from their children with their banking, and not to benefit that child alone upon their death. This causes confusion and encourages expensive litigation. Therefore, lawyers advise clients not to put assets into joint names with their children. Also, usually testators leave to their children, but if the child predeceases the testator, that child's share goes to his or her surviving children. If assets are held jointly with children and the testator and a child dies in a common disaster, the children of the deceased child will not inherit. This usually does not reflect the testator's intention.

Conclusion: Farmers should ensure to seek the appropriate professional advice before leaving any assets in joint names with their children.

Joint assets with spouse or common-law partner

The presumption of resulting trust does not generally apply to joint accounts between spouses or common-law partners.

EXAMPLE 29: Husband and wife open a joint bank account. The wife passes away. In her will, the wife leaves property equally to her husband and her three children. There is a presumption that the husband was to have a right of survivorship to the account. The bank account may be left out of probate to the husband alone.

The rules regarding joint assets may be summarized as follows:

1) Joint assets held by parents and children will be presumed to be held in trust. This presumption can be rebutted if there is clear intention to gift the asset to the child. For example: the child has the ability to withdraw from a joint bank account or use the asset during the parent's lifetime and use it for the child's benefit, and it is clear that the child was intended to have the balance of the asset upon the parent's death.
2) It is up to the child in such a situation to prove the parent intended to benefit that child alone upon the parent's death.
3) Evidence that will be considered: the intention of parent, any documents, who has use and control of the asset, if the parent had a power of attorney, who paid the taxes, what the will provided.

Powers for executor or executrix in will

The estate trustee has the power to manage the affairs of the deceased person's estate. They are responsible to gather together all assets of the estate, pay all estate debts, file tax returns, pay income taxes and finally distribute the estate to the beneficiaries in accordance with the wishes of the deceased in his or her will.

Note: the estate trustee is personally liable for any income tax if the estate trustee distributes the estate before all taxes are paid and notice of assessment issues. The estate trustee has the ability to request a tax clearance certificate from the Canada Revenue Agency for the terminal tax return and any estate tax returns prior to distribution of the estate. If the clearance certificate is granted, the estate trustee is absolved from any liability for tax reassessments. Whether a clearance certificate provides the estate trustee protection ultimately depends on the specific situation. It is recommended that estate trustees speak with a professional advisor about what protection a clearance certificate actually provides in their own specific situation.

The estate trustee's authority comes from the grant of probate given by the court. However, any person who has an interest in the residue of the estate of the deceased has the opportunity to apply to the court for an accounting of the estate if they have concerns on how the estate was handled. The trustee is able to ask for payment for their work in handling the estate and is entitled to compensation, a fair and reasonable fee. If the residuary beneficiaries do not agree on an estate trustee's fees, a court can decide.

Giving to your community

Estate planning provides great opportunities for individuals to benefit the community or their favourite charities. Donations may be made through the will or a trust may be set up by the testator with the charity as the beneficiary. There are attractive tax savings in bequeathing assets or shares to a charity.

Note – recent tax changes that become applicable January 1, 2016 will significantly alter the way in which donations on death will be treated for tax purposes. You should speak with professional advisors as to how these changes will impact any donation planning that you wish to incorporate into your overall estate planning.

Conclusion

Wills and estate planning are complicated and the advice of your lawyer working with your accountant, financial planner and insurance agent or other advisors should be sought. This will allow:

1. the best tax advantages
2. certainty and protection for your future
3. control over your affairs and assets
4. protection for your family if an accident, illness or death occurs

For more information

- Contact your local Manitoba Agriculture Growing Opportunities (GO) Office.
- To find your nearest GO Office, call Manitoba Government Inquiry, toll free at **1-866-626-4862**.
- To find out more about the federal-provincial *Growing Forward 2* initiative and provincial programs and services, go to **manitoba.ca/agriculture**.

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